

Alberta Finance

Employee Benefit Plans and the *Insurance Act*

A New Approach

Background

A common feature of modern compensation schemes offered by employers is the inclusion of a package of benefits, in addition to wages and salaries. The underlying purpose of establishing employee benefits plans is to assist employees and their families in dealing with losses or expenses that arise from an unpredictable event. From the employers' point of view, these additional benefits help attract and retain skilled workers and provide a degree of tax effectiveness, as most benefit payments are tax deductible to the employer, but not taxable to the employee.

Employee benefit plans have grown in scope and importance relative to the total compensation paid to individuals. The range of benefits offered by employers [or unions] includes such health and wellness benefits as vision care, dental care, prescription drugs, short-term illness income replacement, as well as income continuance programs such as long-term disability, and life insurance plans.

Along with the increasing variety of benefits is a complex array of administrative and funding options. Some benefit plans are cost shared and some are paid for exclusively by employers; some are provided through contracts of insurance, some are funded on a "pay-as-you-go" basis and others through a trust on a reserve basis. Some are administered through third-party administrators or insurance companies and some are administered in-house, or a combination of the two.

Employee benefits are essentially a contract or agreement between employers and their employees. Although these plans are established voluntarily or through negotiation, there is an interest in ensuring that benefits offered by employers and relied upon by employees are honored. This interest has already resulted in government regulation of some types of employer or union sponsored benefits, for example, pensions and life insurance.

Regulatory schemes are intended to protect certain promises made to employees by their employer or union. Life insurance and other insurance contracts provided by insurance companies are regulated through the *Insurance Act*. Pensions, which have some characteristics similar to long-term disability plans, are regulated through legislation that sets minimum funding, benefit and disclosure standards. Pension regulations help safeguard benefit entitlements by requiring sufficient assets be set aside to pay for future entitlements or claims. They also help ensure that there is sufficient disclosure to plan members, and that entitlements are paid in accordance with the terms of the plans and in a timely fashion.

Recent interpretations indicate that Alberta's *Insurance Act* applies to employee benefit plans, unless certain conditions are met, in which case an automatic or regulatory exemption occurs. Many employers, consultants, insurers and other stakeholders have not been aware of the application of the *Act* for employee benefit plans. Many of them have argued that these benefit

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arrangements are not insurance and that, sometimes, insurance coverage is not even available for them to offer certain benefit entitlements to their employees. Employers also have indicated that they prefer not to delegate responsibility for these plans to a separate association, to comply with the exemption in the *Act*, as they are integral parts of their overall compensation packages. Further, they have suggested that, if forced to comply with the legislation, they would have to consider either curtailing or eliminating the benefits currently available to their employees, as the cost of the plans could increase significantly.

The Alberta approach of including employee benefit plans under the *Insurance Act* is unique. Some provinces have indicated that they are reviewing the issue of adequate protections for employee benefit plans, but they are not automatically looking to insurance legislation as the vehicle for regulating these benefits.

This paper will review the issues related to regulation of health and income continuance benefits and ask your views about the application of the current system and how it can be improved.

For purposes of this review, employee benefit plans are those arrangements where:

- there is a promise that employees will be reimbursed, in whole or in part, for expenses as they occur. These generally include but are not limited to ambulance, hospital, vision, prescription drugs or medication, or dental expenses not covered by the Alberta Health Care Insurance Plan (AHCIP); or
- there is a promise to replace the income, in whole or in part, lost due to accident or sickness that prevents an employee from working. These are often referred to as sick leave, salary continuance, weekly indemnity, short-term disability or long-term disability plans.

The following are excluded from the review:

- Life and Accidental Death & Dismemberment insurance, as these coverages must be purchased from a licensed insurer under the *Insurance Act*;
- Death benefits up to \$10,000 as allowed under the federal *Income Tax Act*;
- Benefits provided under the *Workers' Compensation Act*;
- Benefits payable under Registered Pension Plans, Supplemental Employee Retirement Plans (SERPs), or other arrangements formed for the purposes of providing a pension. These are not a class of insurance under the *Insurance Act*.

Current System

The purpose of the *Insurance Act* is to protect persons who are relying on a commitment to compensate them for certain losses or expenses. The legislation is aimed at ensuring the entity providing the indemnity can and will follow through on that commitment. Because the definition of insurance is very broad, the legislation has been interpreted to apply to "insurance" arrangements even if they are not provided through insurance companies.

Section 15 of the *Insurance Act* recognizes certain employee benefits, as addressed in this document, as constituting an insurance activity, which would normally mean that the benefits would have to be provided by an insurance contract. The section, however, allows for an

exemption from the *Act* for employers who establish a separate entity with employee participation for the purposes of providing medical care, sickness or accident benefits. The section also allows the Lieutenant Governor in Council to exempt non-profit organizations established for substantially the same purposes.

In 2001, a change was made to the legislation that eliminated income replacement payments payable for more than two years as one of the benefits that could be provided on a non-insured basis by an association under section 15 of the *Act*. There is no option, therefore, but to provide these types of 'long-term' income continuance plans through the purchase of a contract of insurance.

Except for the new requirement to insure income replacement benefits exceeding two years, the recent changes to the *Insurance Act* and Regulations did not change the regulatory regime affecting employee benefit plans. Stakeholders have expressed reservations about the Alberta position. These plans, it is argued, are not insurance, but are important pieces of their total compensation packages. They are either voluntary or negotiated contractual arrangements between employers and employees.

Smaller employers often obtain benefit coverage for their employees through insurance companies. Other benefit plans are administered in-house or are administered by an insurance company or health plan provider, or a third-party administrator, but are not covered by an insurance contract. Some stakeholders have pointed out that certain types of coverage or benefits are not available through the insurance industry. Concerns have also been raised that providing benefits through the purchase of insurance could result in significant increases to the cost of the benefits, and may well result in less or no coverage. And some stakeholders have questioned why the government would force the provision of benefits through insurance, when there may be other ways of protecting employees from loss of benefits, such as an actuarially sound fund. Questions have also been raised as to why the government would interfere in the internal operation of the organization by insisting on employee participation in a separate entity in order to be exempted from the *Insurance Act*.

From a public policy point of view, the issues are these:

- Are employee benefit plans, by nature, insurance, or is insurance simply one way of providing those benefits?
- Should all employee benefit plans be treated the same, or should benefits be treated differently, depending on the nature of the benefit and the degree to which employees are at risk of losing benefit entitlements?
- If insurance coverage is not available, should employees be denied benefits?

Related to these core issues are the following, subsidiary issues:

- Is the establishment of a separate entity with employee representation sufficient justification to exempt employee benefit plans offered by those entities from regulatory protection that would otherwise apply?

- If the protection of certain employee benefits is considered an important policy goal, are there alternative ways of achieving it, other than through the application of the *Insurance Act*?

Options:

1. Status Quo

Employers would be required to comply with the legislation to avoid stiff fines. This could be accomplished by purchasing insurance or, in the case of medical care, sickness and accident benefits, the establishment of a separate entity with employee representatives.

This does not address any of the concerns that have been raised. It would also be difficult and costly to enforce.

2. Develop a new regulatory scheme for the protection of employee benefit plans

Working in partnership with stakeholders, a new regulatory scheme would be developed that would set out permissible alternatives for protecting employees from loss of entitlements resulting from business failure or plan termination. One of the alternatives would be the purchase of insurance. Other alternatives could include the establishment of a separate reserve or trust to hold funds destined for the payment of employee benefits. The assets could cover all or a portion of the liabilities owed on accrued benefit entitlements. Plan termination as a result of a business decision or failure would not affect payment of benefits owed to individuals to the date of termination.

This approach would provide more flexibility in determining how best to provide employee benefit plans and, at the same time, provide a regulatory protection to minimize the risk of financial losses for employees entitled to benefits at the time the plan is cancelled. The regulation could also include provisions for ensuring adequate disclosure to members on the nature of the benefit promise.

This does not address all of the concerns that have been raised. It would also be difficult and costly to enforce.

3. Distinguish between short-term and long-term benefit plans and develop a regulatory framework that focuses protection where it is most needed.

The first part of this option would be to amend the *Insurance Act* to exempt short-term employee benefit plans from the application of the legislation. These plans would include dental care, vision care, prescription drugs and medications and other health benefits not covered by the AHCIP, and disability plans of less than two years' duration. The costs associated with these short-term benefit plans can be anticipated and properly budgeted. This significantly reduces the risk of loss by employees. Further, even if employees lose coverage by termination of employment or plan termination, the actual out-of-pocket losses would be small in most cases.

The second part of the option would be to provide a new regulatory framework for long-term disability (income continuance) plans. It is appropriate to treat disability plans offering benefits that extend beyond two years differently than short-term plans. Employees who are unable to work due to injury or illness and who have been promised long-term income continuation under an employee benefit plan are particularly vulnerable to loss of plan coverage. Further, it is often difficult to anticipate the costs associated with these benefits because, while the likelihood of catastrophic illness or injury may be small, the liabilities associated with a claim can be significant, depending on the salary and age of the employee and the terms of the plan.

Application of the *Insurance Act* to long-term disability (income continuance) plans is one of the options. Certainly, for small employers, it is likely that these arrangements are insured. However, in the case of large employers there are alternatives to insuring the plans with an insurance company that may meet the public policy goal and, at the same time, offer greater flexibility in terms of controlling the costs of providing the benefits to employees. It is also the case that some provisions of long term disability plans are not insurable. Another option, therefore, would be to establish a separate regulatory regime to deal with these plans. A choice would be given between purchasing insurance through an insurance company or self-insuring under a new set of requirements. For example, an actuarial valuation of the program would be used to determine the level of funding needed to meet liabilities under the plan.

This approach would deal with a number of the concerns raised. However, there is some question whether an effective regulatory scheme could be developed, since the universe of plans is unknown. The establishment of a new regulatory regime could impose significant costs on the government with little added protection for employees. There have been very few cases on record where employees have suffered a loss because of the termination of a plan or the bankruptcy of the employer. Further, Alberta would still be out of step with the other provinces.

4. Remove regulatory requirements for all types of benefit plans.

Under this option, the *Insurance Act* would be amended to exempt employee benefit plans from the application of the legislation. This option would harmonize Alberta's approach with that of the other provinces in the treatment of employee benefit plans. Recognizing, however, that there remains a public objective that individuals be protected from loss, best practices guidelines could be established to help minimize potential loss for employees and manage the risk associated with plan liabilities.

Best practices would include recommendations on proper disclosure to employees concerning their entitlements and responsibilities under all types of employee benefit plans. There would likely be special attention given to guidelines governing long-term disability plans given the vulnerability of beneficiaries on termination of these plans.

This approach could mitigate risk at an acceptable cost and also avoid the imposition of an additional regulatory burden on employers who voluntarily provide additional benefits to employees. It would mean, however, that the protections for employees are not regulated.

Input From Stakeholders

The Government is seeking input from stakeholders on the matters discussed in this paper. For example: What should be the appropriate public policy regarding security for employee benefit plans? Do any of the above listed options meet the appropriate public policy objective? Are there other options besides those identified above that should be considered? Please provide comments on any other issues related to this topic.

Consultation Process Timelines

- **June 14, 2002** – release of consultation paper.
- **September 30, 2002** – deadline for written submissions from stakeholders. Stakeholders include:
 - Groups, associations or unions that represent employers and employees
 - Actuaries, insurers and benefit consultants
 - Individual employers and employees
- **October 31, 2002** – complete review of written submissions by Alberta Finance. A summary of the results of the consultation process will be made available to interested persons.

How to Respond

Questions should be directed to:

Mr. Roman A. Wasarab
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Fax: 780-422-4283
E-Mail: Roman.Wasarab@gov.ab.ca

Written submissions should be made to:

Employee Benefit Plans Review
Financial Sector Policy
Alberta Finance
Room 402, 9505 – 107 Street
EDMONTON, AB T5K 2C3

Copies of the *Insurance Act*, *Classes of Insurance Regulation* and *Miscellaneous Provisions Regulation* are available at:

<http://www.finance.gov.ab.ca/publications/insurance/index.html>

Or through the Queen's Printer at:

Queen's Printer
Main Floor, Park Plaza
10611 – 98 Avenue
EDMONTON, AB T5K 2P7
Phone: 780-427-4952
Fax: 780-452-0668

Queen's Printer
Main Floor, McDougall Centre
455 – 6th Street SW
CALGARY, AB T2P 4E8
Phone: 403-297-6251
Fax: 403-297-8450

Appendix 1: Application of Existing Law

The *Insurance Act* and its regulations apply to Alberta residents. Thus, if a benefit plan for a national company covers Alberta employees, it falls under Alberta's *Insurance Act* with respect to those employees.

The key elements of insurance, as reflected in most definitions of insurance, including that used in the *Insurance Act*, are:

- an undertaking of one person
- to indemnify another person
- for an agreed consideration
- from loss or liability in respect of an event
- the happening of which is uncertain.

The *Act* gives the Lieutenant Governor in Council the power to define classes of insurance for the purposes of the *Act*. These include accident and sickness insurance, which have been interpreted to include dental, vision and other health benefits not covered by the Alberta Health Care Insurance Program.

"Disability insurance" is defined, in the *Classes of Insurance Regulation*, as being an additional feature of life insurance, protecting the person whose life is insured from loss of income due to a disability.

The type of employee benefit commonly referred to as sick leave, salary continuance, weekly indemnity, short-term disability or long-term disability is not obtained as part of life insurance, but as part of accident and sickness insurance. Therefore, these types of income replacement benefits are treated as accident and sickness insurance.

Under the existing provisions of the *Act* and Regulation, accident and sickness benefits, including short-term illness or disability benefits with less than two-years' coverage, must be either covered by an insurance policy offered through an insurance company or it must qualify for an exemption from the requirements to insure. To qualify, it must be administered by an entity expressly established for the purpose of providing the benefits that is separate from the employer and that has employee participation. Income continuance programs (long-term disability plans) that provide benefits in excess of than two years cannot be exempted from the application of the *Insurance Act*, even if other benefits are provided through an entity and, in effect, must be covered by an insurance contract.

Appendix 2 – Excerpts from Legislation

From the *Insurance Act*:

- Section 1 - Definitions...
- (g) "body corporate" means any body corporate with or without share capital, wherever or however formed;
 - ...
 - (j) "contract of insurance" includes any policy, certificate, interim receipt, renewal receipt or writing evidencing the contract, whether sealed or not, and a binding oral agreement;
 - ...
 - (q) "entity" means a body corporate, an unincorporated body, the Crown in right of Canada or in right of a province or territory, an agency of the Crown, a foreign government and any agency of a foreign government, but does not include an individual;
 - ...
 - (aa) "insurance" means the undertaking by one person to indemnify another person against loss or liability for loss in respect of certain risk or peril to which the object of the insurance might be exposed or to pay a sum of money or other thing of value on the happening of a certain event and, without limiting the generality of the foregoing includes life insurance;
 - ...
 - (ff) "insurer" means any person that undertakes or effects, or agrees or offers for valuable consideration to undertake or effect, a contract of insurance, including the underwriters or syndicates of underwriters operating on the plan known as Lloyd's, but does not include a person who exchanges with other persons reciprocal contracts of indemnity or inter-insurance as part of a reciprocal insurance exchange;
 - ...
 - (sss) "unincorporated body" means a trust, partnership, fund or other unincorporated association or organization;

Associations that provide employee benefits

15(1) In this section, "association" means an entity that

- (a) is operated by an employer and the employer's employees, or by 2 or more employers directly associated through corporate control and their employees, and
 - (b) is formed for the purpose of providing medical care, sickness or accident benefits for some or all of the employees and the dependants of those employees of the employer or employers.
- (2) This *Act* does not apply to an association if
- (a) membership in the association is restricted to bona fide employees or former employees of the employer or employers,
 - (b) the right to receive medical care, sickness or accident benefits is dependent on the terms of the constitution and bylaws of the association, and
 - (c) the association provides prescribed medical care, sickness or accident benefits.

- (3) The Lieutenant Governor in Council may make regulations
- (a) prescribing medical care, sickness and accident benefits for the purposes of subsection (2)(c);
 - (b) exempting from the application of this *Act* any entity or class of entity that is a non-profit organization, that has substantially the same purposes as an association and that provides the benefits referred to in subsection (2)(c);
 - (c) respecting the terms and conditions that must be met to maintain an exemption under clause (b).

Regulations

- 16 The Lieutenant Governor in Council may make regulations
- (a) defining base capital, electronic media and total assets for the purposes of this *Act*;
 - (b) respecting any matter that is to be prescribed under sections 1 to 12;
 - (c) establishing the classes and subclasses of insurance for the purposes of this *Act*;
 - (d) exempting from the application of this *Act*
 - (i) a specific contract of insurance,
 - (ii) any type of contract of insurance that indemnifies a person who has an interest in a product against the product's malfunction, failure or breakdown, or
 - (iii) contracts of insurance issued by a specified person or class of persons who operate on a non-profit basis;
 - (e) respecting the terms and conditions that must be met to maintain an exemption under clause (d).

From the Classes of Insurance Regulation (AR 121/2001):

Classes of insurance

2(1) The following are the classes of insurance for the purposes of the *Act* and the regulations:

...
(b) accident and sickness insurance;

...
(gg) sickness insurance;

Section 1 - Interpretation

- (b) "accident and sickness insurance" means a class of insurance consisting of accident insurance and sickness insurance;
- (j) "Disability insurance" means insurance undertaken by an insurer as part of a contract of life insurance whereby the insurer undertakes to pay insurance money or to provide other benefits in the event that the person whose life is insured becomes disabled as a result of bodily injury or disease.

...

(gg) "sickness insurance" means insurance by which the insurer undertakes to pay insurance money in the event of sickness of the person insured, but does not include disability insurance;

From the Miscellaneous Provisions Regulation (AR120/2001)

Employee benefit plan exemptions

3(1) The following are the medical care and sickness and accident benefits that are prescribed for the purposes of section 15 of the *Act*:

- (a) any medical care or goods or services that are not provided under the *Alberta Health Care Insurance Act* or are provided after the limits for that care or those goods or services under the *Alberta HealthCare Insurance Act* have been reached;
- (b) income replacement payments that are payable in respect of disability resulting from sickness or accident and are payable for a period of not more than 2 years or, in the case of the Alberta School Employees Benefit Plan, for a longer period approved by the Minister.

...

- (3) It is a condition of maintaining an exemption under subsection (2) that the organization obtain the Minister's approval before the organization increases the benefit level or the scope of benefits provided under the plan it operates.
- (4) Where an organization increases the benefit or the scope of benefits provided under the plan it operates without obtaining the Minister's approval as required under subsection (3), the Minister may reinstate the exemption if
 - (a) the organization applies for the approval as directed by the Minister,
 - (b) the Minister gives the approval, and
 - (d) the Minister is satisfied that the failure to apply for approval as required under subsection (3) was due to oversight or some other acceptable reason in the Minister's opinion.